Prosperity SmartSave Card
An Incentivized Emergency Savings Strategy

Abstract

The Prosperity SaveSmart card is an incentivized, secured credit card that builds emergency savings, provides credit building opportunity, and promotes financial capability. The card provides access to mainstream financial products throughout a network of over 6,000 credit unions, mitigating the high cost of being poor. The SaveSmart card assists families with building savings, a pathway to credit, and opening the family discussion of higher education for children.

This low-touch system will be piloted with 2,000 cards issued during a 6-month period with a control group of an equal amount. The pilot phase will last 24 months. Phase 2 will open the card to public access.

Key Words

Emergency, Credit, Savings, Children, Incentive

Introduction

The need for families in the United States to build contingency funds becomes more critical every day. The assumption that building an emergency savings account within the complexity of financial strife experienced by low income families will bring economic security is an assumption to question. The need for savings is one element of movement toward security, yet the need to build credit is a missing link that cannot be ignored. At the rate that assets are striped out of low income communities, financial strategies to build assets need to be coupled and streamlined. Positive credit is a lifelong asset. Access to emergency funds is a liquid asset that may keep a family from falling into dire poverty.

Key elements of this strategy provide an opportunity for unbanked and underbanked persons in the United States to set aside funds for use in emergency situations. The system suggested herein is one that holds the contingency funds in the most likely mechanism that will be needed for any given emergency – a credit card. The ability to use emergency funds in a credit system manner allows the target market to purchase goods and services at competitive rates and to purchase what is needed regardless of geographic location.

The Prosperity SmartCard is useful to all consumers, yet most useful to the nearly 30 percent of the US population that does not currently have a savings account. More specifically, the Prosperity SmartCard is targeted to the lower income, unemployed, young and one-parent households that fall within that 30 percent that are unbanked and underbanked. Underbanked households are defined as those households that have a checking and/or a savings account and had used non-bank money orders, non-bank check cashing services, non-bank remittances, payday loans, rent-to-own services, pawn shops, or refund anticipation loans (RALs) in the past 12 months. (FDIC, 2012)

Access to common financial transactions is a challenge for the target market. Whether the issue is lack of reasonable access to a financial institution or lack of trust in a financial institution, those who are not participating in the banking system pay higher costs for daily financial transactions. This statement assumes that the consumer is not falling into the high cost of overdraft fees and other banking penalties. This paper lays out the concept for a product that will bring the consumer into the mainstream financial system through an alternative pathway. The consumer will develop banking behaviors and will learn of products and services that may bring a stronger financial floor to the household. The consumer will establish some form of emergency savings, establish savings habits, and build positive credit. Each of these actions is one more step to reducing some of the financial fragility experienced by the target market.

Background

The physical face of banking in America is changing rapidly yet large pockets of low-income and rural consumers remain unable to access financial institution services. If left to depend on using services outside the financial mainstream the high cost of being poor is perpetuated.

The fragility of persons without a financial cushion is not exclusive to those who are in poverty and of very low income in America. Of the 2,667 individuals responding to a July, 2011 poll conducted by the National Foundation for Credit Counseling, 64 percent stated that they would need to tap a source other than their savings account to satisfy a $1,000 unplanned expense. Although 17 percent indicated that they would borrow funds from friends and family, another 17 percent indicated that they would need to neglect existing obligations in order to meet the emergency need. This behavior then snowballs into additional fees as well as negative impacts on the credit report.[1] Over one year later CNN Money reported that only 25 percent of Americans have enough money saved to cover at least six months of expenses, and nearly 49 percent don't have enough saved to cover three months of expenses. This number has grown 3 percent from the previous year's CNN poll. Most alarming is that 28 percent of Americans don't have any cushion whatsoever, which is up from 4 percent the previous year.[2] According to Greg McBride, senior financial analyst for Bankrate.com, stagnant incomes plus prolonged unemployment make it nearly impossible to save, however establishing a savings habit is the first barrier that needs to be overcome.[3]

Even more rudimentary than not having enough savings to weather the slightest unexpected financial impact, nearly 30 percent of US households are unbanked or underbanked[4]. The target population is most likely to use alternative financial services, such as non-bank money orders, non-bank check cashing, non-bank remittances, payday loans, pawn shops, rent-to-own stores, and refund anticipation loans, and they appreciate the convenience of these products.

Problem to be Addressed

Over half of Americans currently manage their lives in a financial state that is unacceptably fragile and not able to accommodate an unexpected financial emergency. This situation is further complicated by the disincentives to establish a savings account associated

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[1] "Majority of Americans to not have Money Available to meet an Unplanned Expense", National Foundation for Credit Counseling, News Release July 2011, www.nfcc.org/newsroom/newsreleases/floi_july2011results_final.cfm, accessed March 4, 2013.

[2] Ellis, Blake, "28% of Americans have no emergency savings", CNN Money, June 25, 2012, accessed March 4, 2013, www.money.cnn.com/2012/06/25/pf/emergency-savings/index.htm

[3] Blake 2012

[4] Burhouse, Susan and Osaki, Yazmin, "2011 FDIC National Survey of Unbanked and Underbanked Households, (September, 2012) 5

with various asset tests that families undergo when receiving public assistance and in some cases the resistance to setting up a savings account that may be garnished for child support or back taxes. Without access to either financial savings or credit, families are left devastated when an emergency hits and are unprepared to manage this life situation. Something as seemingly minor as a $200 car repair can lead to loss of employment and leave a family hopeless as well as homeless.

Use of alternative financial services is a viable resource for many families, however these products must be affordable and must help the family move toward financial independence. A significant element of financial independence is access to credit and access to credit-building products. A negative credit report leads to consumer costs and robs families with limited income of funds that need to be available for daily needs. A positive credit report has become essential in every area of consumer behavior including employment, rental deposits, utility deposits, cost of insurance and basic consumer purchases.

A substantial portion of the services that lie outside of the financial services industry do not feed into the credit-building system. The target market needs a flexible product that connects them to low-cost financial transactions and has mobility.

Over the past two decades, particularly following the American Dream Demonstration, social service agencies have embraced the idea that developing methods to assist lower income families save and purchase assets is a strong economic stabilization tool. What has not kept pace with this development is the understanding of the impact of an individual's credit report and the resulting credit scoring. Too often there is a concentration on building credit for the purpose of one specific asset purchase rather than the lifelong economic benefit of maintaining a “good” to “excellent” credit rating.

Further complications come into play when factoring in the increasing wealth gap that is accentuated by race. The wealth gap between white and African-American families has nearly tripled over 25 years, according to a study released in February 2013 by the Institute on Assets and Social Policy at Brandeis University. Although African-American family income has increased over time, white families have accumulated much more wealth. By tracking families, the study found that the gap between white and African-American family wealth increased from $85,070 in 1984 to $236,500 in 2009. As we creep through 2013, people of color in the United States continue to experience the income gap, the wealth gap, and the credit gap. People of color continue to experience red-lining and unnecessary subprime lending.

Increasing access to safe credit-building products presents an opportunity to accelerate the financial growth of lower income families that are discriminated against in the financial system. Other than the few credit scoring algorithms that take into consideration the home zip code and street address of the applicant, the credit scoring mechanism does not have built-in discrimination tools. Although the mechanism eliminates race as a factor in determining credit worthiness, those that issue the credit are able to take neighborhoods into consideration.

A 2008 study by the Federal Reserve Bank of Boston titled “Credit Card Redlining,” compared people with identical risk profiles and payment histories and found significant differences based on the racial makeup of their neighborhoods. Redlining is a term that describes the illegal practice of denying banking, housing, insurance or other services in certain areas or communities based on race. Decades ago, lenders were said to draw a red line on a map around areas targeted for differential treatment. The research used data on more than 285,000 people supplied by a major credit reporting bureau. The three national credit bureaus are TransUnion, Equifax and Experian. Researchers received the data on the condition that the name of the credit reporting bureau remains anonymous and personal information about individual borrowers was withheld to protect their privacy. Information on racial makeup of neighborhoods was obtained from publicly available U.S. Census tract data.

"I had data that is in principle the same data that the credit card issuers have. I wanted to evaluate the same data they use to make their credit card decisions," said Ethan Cohen-Cole, the financial economist who conducted the study. "When you fill out a credit card application, you do not fill out your race. However, they do know where you live and they do know the racial makeup of where you live. By using that information, you can determine if the racial composition of the neighborhood is one of the criteria they are using." He added: "The fact that credit is being differentiated by location is well known now. The question is whether or not they are also differentiating by racial composition of those neighborhoods ... the answer is yes.

Establishing strong credit and learning how to use that credit wisely is an opportunity available to organizations that work toward child, household and community economic security. Well-managed credit is possibly a person's strongest ally to handle financial emergencies that occur over the lifetime. When a family is consistently living paycheck to paycheck accommodating a financial emergency is simply not possible and building an emergency savings fund is difficult at best.

Coupling the opportunity to build credit with the need to establish an emergency financial fund is a strategy that is needed to move lower income families toward economic security.

Proposed Intervention

The proposed intervention is an accessible, affordable, mobile financial product that builds an emergency savings account simultaneous to building credit. The product ties known human behavior together with opportunity to build lifelong knowledge that aids in credit building and financial management. The best case scenario for this intervention is to thread together products that already exist in a new and meaningful way. The intervention needs little new development, but rather to leverage existing products and resources.

Goals. A primary goal of this project is to connect low-income consumers with the products and services available through mainstream financial institutions, even if they do not actually hold an account in a financial institution. A goal of equal weight is to develop a very low touch system that crosses geography, race, culture, economic class, age, and language capability, that encourages emergency savings behavior and builds credit capacity with low-income consumers.

Objective 1: Simplify, demystify, and mobilize the US financial transaction system.

Objective 2: Establish an accessible conduit that provides incentives for emergency fund savings deposits and for establishing savings for children.

Objective 3: Create a new and viable method to build or repair consumer credit.

Target Population

Key elements of the proposed intervention include ease of use, ease of access, affordability, and mobility. Each of these elements is important to the target population which is households of lower income and little to no credit cushion. The target population includes those who are unbanked and underbanked, providing them a safe and affordable alternative financial product.

With the design of the product tying an individual's emergency savings fund to a secured credit card format, the savings that is set aside will not be considered a liquid savings asset for those that are receiving public assistance with restrictions on liquid assets. The savings is securing a line of credit and the savings immediately becomes the credit line. Although the savings is technically the property of the saver, the saver has access to it only by borrowing against the total sum.

The proposed intervention will be available through organizations that serve lower income families as well as eventually available through convenience stores where competitive products are located. Building on the hypothesis that parents will do for their children what they will not do for themselves, the product design includes rewards that are targeted toward establishing secondary savings accounts for children. As such, immediate and logical distribution networks for this product are those organizations and agencies that are currently involved in Children's Development/Savings Account demonstrations and programs.

The diverse population composition of New Mexico provides an excellent launching ground for the product. Spanish translation of the product features is built into the design. The deep rural pockets of New Mexico will aid in testing the mobility and accessibility of the product. The 21 Native Nations that lie within the state will provide the opportunity to test the uptake of the product within diverse cultures.

Mechanisms

The target market has an exceptionally difficult time putting savings aside due to stressed budgets, the negative impact of savings accounts if receiving public assistance benefits, and competing needs of extended families. Savings that have incentives and access protections built inside the product will reduce these difficulties. Incentives will be tied to savings behaviors as well as repayment behaviors for those who use the emergency savings line of credit.

Below are two examples of utilizing incentives and behavioral economics. <u>Incentives</u>: For every dollar that is deposited into an emergency savings account, up to $1,000, an additional 5 percent will be gifted to a children's savings account each year. Distributions of the incentives will be made monthly for the first year, quarterly the second year, and end at the second year anniversary. So, if the parent deposits $20 into the emergency savings account during month one, she will see a credit of $1 built onto her account statement with a note that that $1 is transferable into a child's savings account of her choice. The credits will continue to build until the parent transfers them to a child's savings account, yet the credits will not be available to the parent's emergency savings account. These children's savings accounts may be formal accounts through a Children's Development Account program, or secondary accounts that the parent is able to establish for their child.

The second example is that of rewarding a <u>savings behavior.</u> On-time payments to the emergency savings secured credit card account will result in bonus dollars deposited into either the children's savings account or back into the emergency savings account, whichever was indicated at the time of enrollment. This bonus of $5 for each monthly on-time payment will be rewarded for the first 3 months of the credit account use. An additional $10 will be rewarded at the next quarter if months 4-6 were paid on time. There are no bonus dollars following the first 6 months.

The Prosperity SaveSmart card initially ties the motivation that parents have to create a better life for their child with the need to create an emergency savings account. The following features are included in the smart card:

(a) facilitate deposits into emergency savings accounts set up as a secured line of credit;

(b) facilitate deposits into established children's savings accounts;

(c) provide incentive to parents/guardians to build an emergency savings account by automated deposits (gifts) into the children's accounts;

(d) provide credit reporting to at least one of the three main credit bureaus and credit-building tips to the users in each monthly credit card statement;

(e) provide access to the products and services of all financial institutions in the Prosperity SmartSave card network (mobility);

(f) provide automated savings hints, financial coaching messages, hot new resources, etc., through push messages to customer mobile phones via text;

(g) provide balance reports and product and service resources via customer text;

(h) incorporate a mobile household budgeting tool that is connected to an enrollment exercise, such as this example from the Australian Government [https://www.moneysmart.gov.au/tools-and-resources/calculators-and-tools/budget-planner];

(i) provide access to savings challenges and reminders (see piggymojo.com/howitworks);

Once consumers are engaged in a financial service product, the space is created for financial management education and the desire to navigate financial systems. Throughout the years of success with gaming tools tied to financial incentives, we know that people enjoy games and prizes regardless of the value of the prize. Savings challenges that are provided through systems such as piggymojo.com, bring the saver the satisfaction of a reward at little cost to the SaveSmart card administration.

As an interactive method of introducing financial products and services that already exist, monthly messages will be pushed out via text that launch a game or a treasure hunt. For example, a message for the month of February, which is Black History Month, is pushed out that launches a treasure hunt to locate the biography of Chicago investment banker Michelle L. Collins. This hunt could take place though a social network platform. Once the biography is located, the customer can complete an auto fill field to claim his/her $1 for the emergency savings account. The abbreviated biography would link to terms related to investment banking such as stocks and bonds and would introduce the concept of purchasing US Savings Bonds during tax time, an option that is now available on the US tax return. These prizes will be limited to the first 2,000 winners as a means of managing the overall expense of offering this financial product budget.

A standing game, available at all times, is related to building credit. This will be developed on a social network platform where points are earned for behavior as well as challenges presented to balance the feeders of credit scoring such as the ratio of outstanding debt on revolving credit cards.

In order to initiate this financial product on a large scale it is essential to lean heavily on automated systems. Programing key words that trigger automated financial coaching messages must be carefully designed and tested. The idea behind the Prosperity Network is to establish a cross-bank system with the SmartSave card. This will initially take place by piggybacking on the shared branching system of the credit unions (http://sharedbranching.org/). There are over 6,000 Credit Union branches throughout the United States that facilitate shared banking where SmartSave card users may walk in and access the full services of their home credit union. By utilizing the Credit Union system as a host of the SmartCard it is possible to take advantage of regulatory barriers that have already been eliminated.

The costs associated with launching this financial product will vary with the ability to tie together products that already exist. For example, piggymojo.com is a system already in place that incentivizes savings through challenges with yourself, your family, your friends and co-workers. With this system already in place there is no need to develop a new savings challenge platform.

Staffing will be necessary for credit disputes, system maintenance, ongoing research and development, and higher touch applications for incentivized savings. The cost of managing the SmartCard is non-existent due to utilizing a prepaid credit card system that already exists.

The cost of establishing and maintaining the network of providers, marketing the card, providing technical assistance to organizations that will offer the card, and managing the initial launch of the financial product include 2 full time staff members and the general cost burden of these members. Assuming that this financial product is launched from the Prosperity Works organization, year 1 and year 2 cost would be $235,000 per year. This includes the necessary evaluation costs, staffing, and initial technical assistance to organizations that will assist with product distribution. The following years would average $165,000 per year for product expansion. Marketing materials will cost $75,000 and the initial technology costs are budgeted at $43,000.

The cost of incentives are:

- 5% gifted to a child's savings account for every dollar up to the first $1,000 that is deposited into the emergency savings account = $20 per credit card holder.
- A maximum of $25 per credit card holder for on-time payment incentives.

Fees associated with cards will include: interest on lines of credit at 11%; a minimal application fee of $15; and a minimal annual renewal fee of $10.

Evidence of Effectiveness

The research on the tie between incentives to save and the savings behavior of people has increased significantly since the mid-nineties. The now old American Dream Demonstration project clarified that low-income Americans will save when incentivized. A 2005 study conducted by the National Bureau of Economic Research analyzed the effects of a large randomized field experiment carried out with H&R Block, offering matching incentives for IRA contributions at the time of tax preparation. About 14,000 H&R Block clients, across 60 offices in predominantly low- and middle-income neighborhoods in St. Louis, were randomly offered a 20 percent match on IRA contributions, a 50 percent match, or no match (the control group). One main finding from the research was that higher match rates significantly raise IRA participation and contributions. Take-up rates were 3 percent for the control group, 8 percent in the 20 percent match group, and 14 percent in the 50 percent match group. Average IRA contributions (including non-contributors, excluding the match) for the 20 percent and 50 percent match groups were 4 and 7 times higher than in the control group, respectively. [5] Doorways to Dreams has published evidence regarding the relationship between savings games and people's desire to save, game playing and the development of financial capability, and taking advantage of the learning moments throughout people's lifespan.

Limitations

Entering into the world of credit building brings instant limitations imposed from the privatized credit bureaus and privatized scoring systems. Each company has their own restrictions on how credit score information may be shared with consumers. Although the

[5] Esther Duflo & William Gale & Jeffrey Liebman & Peter Orszag & Emmanuel Saez, 2006. "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block," The Quarterly Journal of Economics, MIT Press, vol. 121(4), pages 1311-1346, November.

credit report, also referred to as the consumer report, is available for free to all consumers through modifications in the Fair Credit Reporting Act, the credit score is still a cost point. If that score is being obtained by a third party, there are strict limitations on the use of that score, including sharing the score with the consumer. Because the concept for this new financial product is tied into a system that already exists, the score may be shared with the consumer during the credit issuer's regular credit review.

The vision of the Prosperity SmartCard may also experience limitations within our target market with the functionality of loading the card, or making deposits to the card. Assuming that the card will function within the shared branching system of the credit unions, the target market will still need to become a member of a local credit union. Membership into credit unions is often restricted by geography, employment or participation in another membership-based organization. The approach to overcoming this limitation is to qualify a SmartCard holder as a Prosperity Works participant and that Prosperity Works is a qualifying member organization for several credit unions.

Evaluation

During the first two years of the distribution of the Prosperity SmartSave card, up to 1,000 cards (an equal amount of control group cards) will be issued that do not contain the added features related to building a savings structure for a child. At the core of this card is the thesis is that parents will do for their children what they will not do for themselves. By eliminating the relationship between the adult's ability to build emergency savings and the desire to build savings for children, we will be able to test the impact of tying the emergency savings credit card to a benefit for the child.

Expected outcomes are an increase in the family's ability to weather unexpected financial impacts and an expressed desire to open savings accounts in the name of their children.

The launch evaluation is tied to the first two years of the card's lifespan. Measurements will be taken on the following schedule:

- Participant uptake – quarterly review of numbers of applicants and numbers of participants enrolled
- Rate of savings – quarterly review of the amount that people are savings and the relationship between the 5% child savings incentive and the increase in savings. Surveys will be conducted at every 6 month period to request input from the savers regarding the impact that this incentive may have had on their savings behavior.
- Uptake on credit card – quarterly review of numbers of secured credit card applications and numbers of cards issued.
- On time payments – reviewed every 6 months.
- Credit building and repair – reviewed annually.

Following the two-year evaluation period a six-month development period will allow for necessary refinements before making the card available to the public at large.

Conclusion

By incorporating a credit-building mechanism into an emergency savings product, the target market is able to build sustainable systems that enhance their ongoing financial needs and eventually reduce their lifelong costs of purchasing goods and services.

It is important to incorporate comparative cost information through automated financial education so that the product users understand the potential high costs of using alternative financing methods, as well as the potential dangers of not paying the credit card on time.

A key strategy within this product is its mobility and lack of dependence on any one financial institution. The SmartCard needs to be as flexible and mobile as the target market. By incorporating the parent’s motivation to care for their children this strategy helps overcome the tendency of parents to “go without”. It also brings attention to the need to pass on financial knowledge from parent to child, thus tying a psychology need for the parent to learn to manage their emergency funds wisely.